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| IN THE MATTER OF THE APPLICATION OF THE GENERIC PROCEEDING CONCERNING ELECTRIC RESTRUCTURING ISSUES | Docket No. E-00000A-02-0051<br><br>**SUPPLEMENTAL COMMENTS OF FREEPORT-MCMORAN COPPER & GOLD INC. AND ARIZONANS FOR ELECTRIC CHOICE AND COMPETITION** |

Freeport-McMoRan Copper & Gold Inc. and Arizonans for Electric Choice and Competition (hereafter collectively "AECC") hereby submit these "Supplemental" Comments in response to Arizona Corporation Commission Staff's ("Staff") request dated March 12, 2010 in connection with the above-referenced matter. These Comments follow the six (6) main questions raised by Staff during its November 18, 2008 workshop on retail competition. These Comments also address some of the written comments submitted by other parties on January 30, 2009. For reasons more fully addressed herein, AECC urges the Arizona Corporation Commission ("Commission") to move forward with retail electric competition in order to provide the benefits of such competition to the consumers of Arizona.

## RETAIL ELECTRIC COMPETITION

1. What are the Potential Benefits and Risks Associated with Retail Electric Competition?

Significant customer benefits would result from re-introduction of retail competition (or "direct access service") in Arizona. These benefits include: (1) downward pressure on electricity prices through access to lower-cost power in competitive markets; (2) improved customer service and more options for different and/or new services through competitive suppliers; (3) further innovation in generating technologies, grid management, information technology and new energy products; and (4) the potential to reduce environmental impacts of energy generation.[1]

There would be little downside risk to re-introducing direct access Service in Arizona. AECC is not proposing that the Commission abandon current cost-of-service regulation. No customer would be forced from cost-of-service rates over which the Commission would still assert jurisdiction. Customers would simply have an alternative option for obtaining generation supply. This is a very low risk proposition.

In examining the services offered in retail electric markets, it is readily apparent that "retail markets appear to be delivering on the promise of new, varied and innovative products and services" that fall into four broad categories: new pricing options, clean energy products, innovative technology solutions (the use of internet/software solutions for energy management as well as more traditional technology solutions such as HVAC and local control technologies), and customization.[2] For example, a variety of pricing options are being provided along a continuum, from totally fixed prices to real-time pricing, as well as fuel-based pricing. Specific clean energy products include "variations on green power offerings, carbon offsets and renewable energy credits, demand response products and services, energy efficiency and facilities management, as well as advisory services for obtaining grants and other related offers and general eco-branding services."[3]

Retail electric competition also enhances the development of commercial sized renewable energy projects, especially solar generation. Although investor-owned utilities

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[1] It is likely that electricity from generation plants that produce high carbon emissions will become more expensive in relation to electricity produced by cleaner technologies over the long term.

[2] Karl A. McDermott and Carl R. Peterson, "Innovation in Retail Electricity Markets: The Overlooked Benefit," National Economic Research Associates, Inc. (March 2008).

[3] *Id.*

are required by the Commission to generate a certain percentage of their electric generation from eligible renewable resources, it does not appear likely that affected utilities are willing to produce an amount beyond these "minimum" standards without ratepayer funding.[4] Allowing third-party electric service providers to directly offer Arizona consumers "green" generation will enhance the likelihood that small commercial-sized projects can be constructed in areas conducive to such distributed generation. Furthermore, as the Commission increases its focus on coordinating the construction of transmission infrastructure and renewable energy interconnections along renewable energy corridors within the state, the price of renewable energy produced within the state can be more competitive as transmission pricing becomes less vulnerable to congestion costs and other impediments.[5]

In a competitive market, the development of innovative products and offerings are the result of market investment. Texas and New York have developed the most active competitive retail energy markets. In Texas, customer choice has significantly increased since restructuring began in 2002. In January 2002, the typical Texas consumer could choose from 17 rate plans offered by 4 retail electric providers. By 2006, there were 23 retail providers offering nearly 85 different rate plans. In fact, consumers now have the option to select from one of many 100% renewable energy products available in the market. There is also evidence that retail electric competition has applied downward pressure on the price of electricity for residential consumers.[6]

Salt River Project and New West Energy ("SRP") state in written comments submitted on January 30, 2009, that prices have increased overall since deregulation

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[4] Commission regulated entities have filed Renewable Energy Standard Tariff ("REST") Implementation Plans that describe how each is likely to achieve minimum standards based primarily on funds generated by monthly ratepayer surcharges authorized by the Commission.

[5] Arizona Corporation Commission: Fifth Biennial Transmission Assessment, October 15, 2008.

[6] Public Utility Commission of Texas, "Electricity Pricing in Competitive Retail Markets in Texas," at 1 (February 2006); "Texas Retail Competition, Impact on Residential Prices 1995-2008," *Intelometry* (December 1, 2008).

began in Texas, without referencing the increase in the price of natural gas. However, those same prices today are lower because of the competitive retail market, and because of a decrease in the price of natural gas.

New York ratepayers have also experienced the benefits of retail competition. The implementation of retail electric restructuring in New York provided the following benefits which flowed to consumers who chose competitive suppliers: (1) increased supply choices through value added products and services, (2) downward pressure on prices, (3) enhanced price transparency for all customers, especially residential consumers, (4) environmental improvements through energy efficiency and demand response, and (5) reduced stranded costs for ratepayers.[7] Between 9 and 22 suppliers offer services to residential customers (between 22 and 40 suppliers offer services to non-residential customers) in each service territory.

SRP argues that the average cost of electricity in New York does not compare favorably with rates in neighboring states. However, recent data shows that electric rates in the New York service area have actually decreased 49% over 2008 rates. Like in Texas, New York consumers are beginning to realize the pricing benefits competition can bring.

Texas and New York are but two examples of several states that have adopted and implemented some form of retail electric competition since restructuring began in the late 1990s. Various other state rules and regulations governing retail competition have been revised from time to time to address changed circumstances. AECC expects that the Commission will periodically revisit the Rules– as the Commission is doing in this proceeding – to ensure that they adequately protect Arizona ratepayers while developing a robust competitive retail market.

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[7] Capitol Hill Research Center White Paper "Retail Electric Competition In New York: Benefits for the Present, Promise for the Future" (May 2007).

Ironically, the State of California (which many point to as a shining example of why retail competition will never succeed) recently adopted enrollment procedures for the reintroduction of its Direct Access program. The transition period, which is set to begin April 11, 2010, will continue for four calendar years, with annual limits on direct access load increase during that span. Clearly, retail electric competition in California was not a success 10 years ago. However, now that California regulators know some of the causes for the failure, including market manipulation that was occurring at the wholesale level, the building of a robust competitive retail electric market has more likelihood of success.

2. Is Retail Electric Competition in the Public Interest?

As noted above, the reintroduction of direct access service will provide an opportunity for competitive providers to offer new benefits to ratepayers. Since the adoption of the original Rules in Decision No. 59943 (December 26, 1996)[8], the Commission has *consistently* reaffirmed that the development of retail electric competition in Arizona is in the public interest. For instance, in Decision No. 68485 (February 23, 2006), the Commission determined that the Arizona Independent Scheduling Administrator ("AISA") "provides the important *public benefit* of keeping the possibility of retail access available to Arizona consumers at a minimal cost, by providing potential competitors with the necessary assurance that they will have fair and equitable access to transmission until an RTO is formed and approved by FERC to take over that function." [emphasis added]. Decision No. 68485 at 15.

Likewise, the Arizona State Legislature has determined that competition is in the public interest. A.R.S. § 40-202(B)(5) ["It is the public policy of this state that a competitive market shall exist in the sale of electric generation service."].

In addition to the benefits already mentioned herein, retail choice can facilitate

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[8] Docket No. U-0000-94-165, *In the Matter of the Competition in the Provision of Electric Services Throughout the State of Arizona.*

real-time electricity pricing, which is a critical component of an efficient restructured electricity market. Real-time pricing can result in long run efficiency gains in the generation and consumption of electricity. One study concluded that the benefits of real-time pricing are likely to outweigh the costs for those customers who are most price responsive.[9]

Competition will also allow ESPs to more rapidly respond to customer choice for renewable generation on a customer-by-customer basis, complimenting existing Commission-approved utility programs. According to the U.S. Department of Energy's Office of Energy Efficiency and Renewable Energy, more than 50% of all retail customers in the United States have an option of purchasing a "green power" product directly from an electricity supplier.

While Commission-regulated electric utilities must comply with REST requirements, there is no requirement that the renewable power is actually generated in Arizona. Indeed, Arizona Public Service Company's green choice programs are powered primarily through purchases of wind and geothermal energy produced outside the state. The addition of customer choice, and the ability to choose the specific types of renewable generation purchased from a supplier should accelerate the development of solar energy within the state; market forces should drive the development of larger scale solar facilities at locations that are closer to load centers, and that can take advantage of new transmission lines built to help facilitate the construction of these in-state projects. The efficiency gains and additional supply choices realized under competition, incentives for innovation among industry participants, and environmental gains associated with innovation and efficiency outweigh the risk of price volatility, which can be minimized when customers can also elect to take standard offer service.

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[9] Severin Borenstein, "The Long-Run Efficiency of Real-Time Electricity Pricing" (February 1, 2005). *Center for the Study of Energy Markets*. Paper CSEMWP-133R.

To SRP, the response to customer choice is simple; why would a customer want to leave a utility that provides award-winning service at reasonable rates? If SRP is so confident that due to its "award-winning service" none of its customers would leave the utility, then it has no reason to fear customer choice. In addition, the SRP view is a rather myopic view because not every electric utility customer in Arizona is served by SRP. The purpose of the Rules and related legislation is to bring competition-derived benefits to all energy consumers, not just those in SRP's service territory. Furthermore, it should be a customer's choice to determine for him or herself whether SRP's customer service is award winning, or whether the price of electricity is reasonable given the alternatives.

3. Provider of Last Resort Issues.

Arizona statutes address Provider of Last Resort ("POLR") issues. A.R.S. §§ 30-806(I) and 40-202(B)(5) codify POLR consumer protections. A.R.S. § 30-806(I) states:

> A public power entity that has a service territory in this state through certificates of convenience and necessity, resolutions of public power entities or contracts or agreements among utilities shall act as the *supplier of last resort for electric generation service for every retail electric customer within its service territory whose annual usage is one hundred thousand kilowatt hours or less if other electricity suppliers are unwilling or are unable to supply electric generation service and whose electric generation service has been discontinued through no fault of the retail electric customer*. Public power entities that provide electric distribution services are entitled to recover just and reasonable costs for supplying electric generation service under this subsection through a distribution charge on retail customers whose annual usage is one hundred thousand kilowatt hours or less. Public power entities and the commission shall coordinate their respective rules and procedures to provide statewide uniformity. [Emphasis added]

Likewise, A.R.S. § 40-202(B)(5) states:

> It is the public policy of this state that a competitive market shall exist in the sale of electric generation service. In order to transition to competition for electric generation service, the commission's authority is confirmed to:

> (5) Require the electric distribution utility that is a public service corporation to act as the supplier of last resort for electric generation service for every retail electric customer within its electric distribution service territory whose annual usage is one hundred thousand kilowatt hours or less if other electricity suppliers are unwilling or are unable to supply electric generation service and whose electric generation service has been discontinued through no fault of the retail electric customer.

The Commission adopted POLR provisions in the Rules that are consistent with these statutory authorities. While POLR protection is limited to retail electric customers whose annual usage is 100,000 kWhs or less, this generally encompasses all residential customers and many small to medium size business customers. Further, the Commission has provided an even broader consumer protection that backstops the POLR statute by requiring that Affected Utilities must offer Standard Offer service to all customers in their service territories. This provision ensures that customers of all sizes, both residential, commercial and industrial, can remain utility customers at Commission-approved rates if they so desire. At the same time, Arizona Public Service Company and Tucson Electric Power Company tariffs require larger customers (annual consumption of 3 megawatts or more) to provide at least one (1) year notice to the affected utility, under applicable Direct Access tariffs, before returning to the system after purchasing generation service from a competitive ESP.[10] This provision provides reasonable notice to the provider of POLR service that a larger customer intends to return to Standard Offer rates.[11] It is clear from the statutory and administrative authorities cited herein that residential and business customers will have POLR protection in a competitive retail market.

The primary challenge moving forward, however, involves synchronizing the

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[10] Utilities with Commission-approved Direct Access Tariffs also generally require the payment of up-front costs for a large customer to return to the system without the requisite notice in order to protect current customers from absorbing these costs.

[11] A.A.C. R14-2-1606(A) "...Standard Offer Service and Noncompetitive Services shall be provided by Utility Distribution Companies who shall also act as Providers of Last Resort."

POLR responsibilities of affected utilities to their short and long-term integrated resource planning activities. This can be accomplished by, among other things, requiring affected utilities to develop resource procurement plans every two years, taking into account such issues as customer growth, environmental concerns and sustainability, national energy policy, renewable energy sources, and fuel price volatility.[12] This is consistent with traditional POLR requirements in states that have implemented retail competition where POLR service is the long-term option for customers. Regulated standard offer service becomes the "price to beat", and alternative suppliers may enter the retail market and grow as they find additional approaches to attract customers.

Because affected utilities face challenges in synchronizing energy procurement with customer needs, resource planning in the face of POLR responsibilities and retail competition would not present any *new* challenges, but rather modified challenges that are already being impacted by such issues as renewable energy, demand side management, energy efficiency and time-of-use rates. Despite SRP's attempt to cast the POLR issue as an insurmountable impediment to the introduction of retail competition, such is simply not the case as clearly demonstrated above.

4. Are the Current Retail Electric Competition Rules Adequate for the Provision of Retail Electric Competition?

Although certain portions of the Rules were invalidated by the Arizona Court of Appeals in *Phelps Dodge Corp. v. Ariz. Elec. Power Coop.*, 207 Ariz. 95, 83 P.3d 573 (App. 2004), the implementation of direct access and retail competition through the issuance of certificates of convenience and necessity ("CC&N") to prospective ESPs

[12] In fact, the Commission recently promulgated rules on Integrated Resource Planning that requires load-serving entities to provide a 15-year resource plan to the Commission every TWO years. The frequency of review and analysis by both load-serving entities and Commission Staff over resource plans suggests that more accurate forecasts can be made even with the element of retail competition and renewable energy affecting current and future loads.

remains largely intact.[13] The *Phelps Dodge* court recognized that invalidating a portion of the Rules did not remove the Commission's ability to issue CC&Ns for ESPs; the court merely clarified that when setting a range of permissible rates and charges, the Commission should consider fair value. *Phelps Dodge* at 106, 584. Therefore, there is no substantive legal impediment based on *Phelps Dodge* that would limit the Commission from considering a CC&N application at this time.

A.R.S. § 40-202(B)(2) confirms the Commission's authority to promulgate rules for certificating and regulating ESPs as part of the legislature's stated public policy that a competitive market for electric generation shall exist in Arizona. Coupled with the statutory requirement that public service corporations obtain their CC&Ns before providing service in any particular area [A.R.S. §40-282], the Commission is given broad authority to implement rules and regulations that govern how retail electric competition will be structured within the state. Although a portion of the Rules was declared invalid on constitutional grounds, those declared invalid for lack of certification can be rehabilitated by merely submitting them to the Arizona Attorney General for certification. As a practical matter, a solid framework currently exists to enable the Commission, without having to make any significant changes to the Rules that have already undergone so many revisions, to re-introduce retail electric competition.

5. <u>What are the Costs of Competition?</u>

There are three major "ratepayer costs" associated with competition in Arizona that, ironically, have already been paid (or are being paid) by customers of Commission-regulated entities. These sunk or embedded costs include: (1) stranded costs, (2) transition costs, and (3) the cost to develop and implement the Arizona Independent Scheduling Administrator ("AISA"). Easy to quantify in terms of real dollars, the AISA requires continued ratepayer funding in order to facilitate direct access service throughout

[13] *I.e.* Court actually upheld the Rules.

the state, for retail competition and renewable energy. These costs would be minimal. Once Arizona retail competition is again permitted to go forward, development costs will likely be born mainly by market participants seeking to bring new products and pricing programs to prospective customers.

6. Miscellaneous Issues.

Although the *Phelps Dodge* decision invalidated several CC&Ns previously granted to ESPs seeking to provide retail products to consumers, the Commission is not prohibited from reinstating any of these CC&Ns, after an appropriate §40-252 hearing, and provided that financial safeguards are in place to protect consumers from any non-viable entities seeking to enter the retail market. As for new entrants, the Commission should streamline the CC&N approval process so that new energy products and services can be offered to customers, provided once again that new market-entrants are able to establish the requisite financial assurances to the Commission. As with telecommunication companies, offerings for energy products and services can be reviewed and approved in a timely manner to allow more timely access to these new offerings.

## CONCLUSION

The continued development of competitive retail electric markets in Arizona is in the public interest because of the benefits it can bring to consumers. Retail competition can also bring consumers more choice in the availability of renewable energy products. The market can allow these products to compete against those renewable energy programs made available to ratepayers through incumbent utility programs. Competition is likely to drive down the costs of renewable energy implementation, forcing incumbents to become more efficient in their use of ratepayer dollars to implement REST programs. In addition to giving customers a choice in the type of energy products available to them, a system based on real-time pricing is likely to make power consumption more efficient, provided that the proper price signals are being considered in the marketplace. Finally, there is no requirement that incumbent utilities must divest generation assets in order for a retail competitive market to develop, which is the case in several U.S. states. Indeed by all accounts, the wholesale competitive market in Arizona has been a success despite the existence of vertically-integrated utilities that continue to own generation assets. Moreover, the existing Rules provide a strong framework that can be shaped and modified when needed to address an ever-evolving market. For the reasons set forth above, AECC urges the Commission to move forward with retail electric competition in Arizona.

RESPECTFULLY SUBMITTED this 2nd day of April, 2010.

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